Service Date: June 17, 1994

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER Of The Application	)	UTILITY DIVISION
Of The MONTANA POWER COMPANY For	)	
Authority To Change Rates For	)	DOCKET No. 93.7.29
Electric Service.	)	ORDER No. 5735c

* * * * *

FINAL ORDER

APPEARANCES

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FOR THE COMMISSION

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BEFORE:

Bob Anderson, Chairman
Bob Rowe, Vice Chairman
Dave Fisher, Commissioner
Nancy McCaffree, Commissioner
Danny Oberg, Commissioner

FINDINGS OF FACT

BACKGROUND

1. On August 16, 1993, the Montana Public Service Commission (Commission) received an application from the Montana Power Company (MPC) for authority to change rates for electric service based on its allocated cost of service and rate design study.

2. On August 20, 1993, the Commission issued Procedural Order No. 5735, establishing the procedural schedule in this Docket and a tentative hearing date. Pursuant to the Procedural Order, the following have been granted intervention in this Docket:

Montana Consumer Counsel (MCC)
Department of Natural Resources and Conservation (DNRC)
District XI Human Resource Council (HRC)
U.S. Federal Executive Agencies
Large Consumer Group (LCG)
Colstrip Energy Limited Partnership (CELP)
Rhone-Poulenc Basic Chemicals Company (RPC)
Continental Hydro Company

3. On September 29, 1993, the Commission issued Protective Order No. 5735a, limiting access to and use of RPC information relating to the annual cost of the factors of production of elemental phosphorous at RPC's Montana plant.

4. On October 28, 1993, the Commission issued Interim Order No. 5735b, granting MPC's Motion for Interim Approval of a proposed electric industrial retention interruptible rate schedule (EIRI-2) for service to RPC.

5. On November 23, 1993, the Commission issued a Notice of certain additional issues to be addressed by the parties according to a schedule established in the Procedural Order.

6. On February 22, 1994, the technical hearing commenced in Helena. Public satellite hearings in this Docket were also held at several locations throughout MPC's service territory.

7. The following persons testified on cost of service/rate design issues in this Docket:

For MPC:	James Falvey	For MCC:	John W. Wilson
	Philip Maxwell		John Bushnell
	Mark Stauffer		
	William A. Pascoe	For HRC:	Thomas M. Power
	Thomas E. Wilde		

Patrick R. Corcoran For LCG: Katherine E. Iverson Alan Rosenberg
For DNRC: Larry Nordell
For CELP: Mark Henwood

I. Production Cost Stipulation, Cost Freeze and Cost Collaborative

8. MPC, MCC and LCG entered into and submitted to the Commission a Stipulation Agreement Regarding Marginal Production Costs in this Docket. (MPC Exh. 3) The Stipulation Agreement states in part:

> The parties agree that the Commission should approve the agreed-upon values for this Docket only, but should not endorse a particular method for calculating marginal production costs in this proceeding. The parties further agree that the Commission should also encourage the parties to seek agreement on a common methodology to be proposed to the Commission for future cases.

9. Partly as a result of this Stipulation, the Commission staff advised the Commission to consider freezing all cost issues in this Docket and to establish a collaborative to attempt to resolve or narrow differences among the parties on cost issues prior to the next COS/RD docket. The Commission directed staff to discuss the proposal with the parties and to report back.

10. At an April 26, 1994 meeting with staff the parties expressed some reservations over, but generally embraced the idea of, a cost freeze and cost collaborative. Therefore, the Commission takes the unusual step of refraining from deciding the contested cost issues in this Docket. The Commission encourages the foundation of a collaborative discussion among interested parties in this Docket (and perhaps other interested persons) to attempt to resolve or narrow differences on costing principles and methods. Commission staff will participate as fully as possible in the collaborative.

11. The Commission expects that contentious issues in generation, transmission and distribution costing will be

addressed in the collaborative. Other issues that should be addressed are off-system opportunity sales values and the cost basis for off-peak winter and summer capacity. Other issues may appropriately be addressed as well, at the discretion of the collaborative. While the collaborative may not reach a consensus on each cost issue, it should attempt to narrow the range of differences that currently exist.

12. The Commission recognizes that the success of the collaborative may depend on minimizing the size of the discussion group. However, in addition to the parties in this Docket that testified on cost issues, the Commission suggests that certain others should be notified who may have an interest and stake in at least some of the collaborative discussion. These could include, for example, the Montana irrigators and the Montana League of Cities and Towns.

13. The Commission expects that the collaborative process will conclude as rapidly as possible. The Commission agrees to the collaborative process in part because the revenue increase out of Docket No. 93.6.24 is relatively small, which minimizes the impact of freezing cost decisions in this Docket. This creates, in effect, a window of opportunity for the collaborative process. It is important, however, that the collaborative be completed in time for MPC to incorporate the results into the next COS/RD filing, and that the Commission's next cost decisions be applied quickly to the next revenue requirement change.

14. The issues that remain to be decided in this Docket are discussed below.

II. Rate Design Issues

15. Though cost issues have been referred to a collaborative, certain rate design issues remain.

Residential Tariff

16. MCC and HRC recommended the following changes.

17. HRC witness Power recommended abandoning the current seasonal differentiation. In lieu of the flat summer energy rate, Dr. Power would substitute an inverted-block structure that would mirror the inverted-block winter rate structure. Dr. Power added that the low-income stipulation was not intended to decide the issue of seasonal differences in cost of service.

(Tr. p. 568)

18. MCC witness Wilson testified that MPC should not continue its residential employee 40 percent discount, especially given the increased employee electricity consumption caused by the discount. Dr. Wilson argued that direct compensation would be better. At hearing, he agreed that if the discount becomes part of the employee's compensation, the tax impacts would have to be taken into account. (Tr. p. 441)

19. Commission Decision. Neither of these issues should be decided in this Docket. Given that cost issues will not be decided here, rate design changes ought to be deferred also. In addition, due to the revenue impacts of alternative methods of employee compensation, that issue ought to be decided in a revenue requirements proceeding.

General Service Tariff

20. MPC proposed several changes to the General Service (GS) tariff, including optional off-peak service, demand metering and elevator rates.

21. First, MPC proposed an optional off-peak service (OPS) for GS-1 (and GS-2) customers. It cautioned, however, against a major expansion of time-of-day rates pending a Commission decision on cost of service issues. Further studies on meter costs and customer reactions also must be performed.

22. Second, MPC proposed to establish criteria to determine whether a customer should be demand metered. In its GS-1 tariff MPC proposed adding language that reads: "Demand Meter: At the Utility's discretion, it may install a demand meter on any customer whose average monthly usage exceeds 2,500 kwh or who has an average peak demand of 11kw or greater, over the applicable period." Conversely: "Non-demand metered customers are customers who use less than 2,500 kwh per month and have a demand less than 11kw on average."

23. Third, MPC requested the elimination of direct current (DC) elevator language from the GS-2 Rate schedule, arguing such customers no longer exist.

24. Commission Decision. The Commission approves eliminating the DC Elevator language from the tariff and approves the tariffing of demand metering criteria. The Commission does

not approve expanding OPS, which should await a review of underlying methods of costing.

25. In approving the demand metering criteria, the Commission assumes the proposed tariff language reflects MPC's actual practice. The Commission questions why demand metering should be discretionary if the proposed conditions are met. This can be reviewed in another docket.

Post Top Lighting Tariff

26. MPC proposed to discontinue offering 8-foot Ornamental Lawn Lights under the Post-Top Rate Schedule. If approved, new requests for service will be denied and existing service continued.

27. Commission Decision. The Commission approves this proposal.

Street Light Tariffs

28. MPC proposed removing from the tariff rates for mercury vapor and incandescent lights; it proposed adding a Special Term and Condition on the customer-owned schedule that would allow for optional metered rates.

29. Two other street light issues were reserved from MPC's last cost of service docket. One involved an option to have metered street light service. The other involved selling company-owned street lights to customers.

30. Commission Decision. The Commission approves these proposals. First, eliminating obsolete lighting options can only make the lighting tariffs more accurate and understandable. The Commission approves the tariff language that allows a customer the opportunity to manage its energy usage. Customers must pay for the necessary equipment (metering, controls, etc.) and installation. (Tr. pp. 600-601) The Commission also approves MPC's commitment to enter into discussions with municipalities to consider selling street lights so long as mutually agreeable terms and conditions can be struck. (Tr. p. 602)

Irrigation Tariff

31. MPC's proposed rate design and its responses to reserved issues from Docket No, 90.6.39 are as follows. Table 1 contains MPC's existing and proposed irrigation rate design. On rebuttal, MPC submitted a significant correction to its pre-filed

testimony involving at what level it would demand meter its customers: "Demand Meter: At its discretion, the Utility may install a demand meter on any customer whose average monthly usage exceeds 3,800 kwh or who has an average peak demand of 15kw or greater, over the applicable period." (MPC Rebuttal TEW-2)

Table 1
Irrigation Tariff Rates

	Rates As Of October 1993	MPC Proposed Rates
Demand Metered		
Customer Charge	$89.26/season	$128.09/season
Demand	$5.30/kw	$4.20/kw
Energy	$0.02845/kwh	$0.036973/kwh
Non-Demand Metered		
Customer Charge	$37.46/season	$73.12/season
Energy	$0.046827/kwh	$0.053637/kwh

32. MPC also responded to the seven Commission questions reserved from Docket No. 90.6.39. MPC responded that the absence of third-party determined "rate" applicability makes irrigator eligibility difficult to determine for low-income conservation opportunities; however, after further study, MPC noted that a pilot irrigation conservation program could be expanded. MPC found little merit in individual customer rate moderation, adding "retention rates" for irrigators would be difficult to administer and could cause revenue instability. Also, MPC asserts there is no merit in abandoning demand charges for irrigators, adding time-of-day irrigation rates are not appropriate.

33. Finally, MPC addressed the Commission's interest in an inverted irrigation demand charge rate structure. MPC believes it already addresses the concerns of small usage low-load factor demand-metered customers by billing such customers on the non-demand metered rate.

34. Commission Decision. The Commission approves the tariff language describing when demand metering will be applied. This is consistent with the Commission's decision on General Service demand metering language. Otherwise, the irrigation class' rates will be treated similarly to other class' rates: All rates will change by a uniform percentage amount (see FOF No. 121).

LTQF Avoided Cost Tariff

35. MPC proposed four changes to its LTQF tariff. First, it proposed rates for future on-line dates that extend six years

into the future, instead of ten years. In addition, MPC would continue offering real-levelized energy rates for on-line dates extending six years into the future. Second, MPC proposed that the maximum contract length would decrease from 35 to 25 years. Third, MPC proposed biennial, instead of annual, tariff updates. Last, although paid in both seasons, winter capacity payments are only available on a time-of-day basis, a change gleaned from the tariff and not any prefiled testimony.

36. CELP does not favor allowing MPC to implement the revised avoided cost method. Also, CELP contends MPC must be held accountable for bringing in its own resources, on which avoided costs are based, at the same avoided costs. Finally, CELP expressed concern with basing MPC's avoided costs on short-term purchase costs. On another issue, CELP echoed HRC's concern over MPC's modeled seasonal generation capacity costs, which involves how avoided costs relate to expected unserved energy.

37. Commission Decision. The Commission's decision to freeze cost decisions in this Docket impacts the need to revise MPC's avoided cost tariff. The Commission does not approve the winter season on- and off-peak capacity payment; this is consistent with the Commission's decision not to approve MPC's newly proposed avoided cost method and results. The Commission also does not approve MPC's proposal to decrease maximum contract lengths to 25 years. If MPC commits to treat its own resource acquisitions equally, there could be merit in this proposal.

38. As MPC's other proposals are not integrally linked to the method of calculation, MPC may make such changes in its next avoided cost filing.

39. The Commission has addressed all of CELP's concerns. The freezing of cost decisions makes moot the implications of expected unserved energy on MPC's avoided costs. The rejection of MPC's proposed avoided cost method and results should make moot CELP's other concerns.

The Rhone Poulenc EIRI-2 Tariff

40. For the second time, MPC has proposed an Electric Industrial Retention Interruptible (EIRI-2) rate for Rhone Poulenc Basic Chemicals Company (RPC). The Commission approved EIRI-2 on an interim basis in October 1993. Due to the absence of information on the cost to serve RPC on the Interruptible Industrial (II) tariff, the Commission required MPC to file Additional Issue testimony. The following is a review of direct and additional issue testimony on the subject of the EIRI-2 rate, followed by the Commission's decision. Three parties (MPC, RPC and MCC) filed testimony on the EIRI-2 rate.

41. MPC designed the EIRI-2 rate to meet a goal and a constraint. The goal is a rate level that allows RPC to compete with two Idaho firms (FMC and Monsanto). The constraint was to leave other customers and/or stockholders "indifferent" to the rate impacts of load retention and that the revenue shortfall be recovered in other customers' rates. MPC attempted to make customers and stockholders "indifferent" by basing the EIRI-2 price on a power sale to BPA (MPC DR PSC 1-004-a); that is, the opportunity cost of the EIRI-2 rate was a power sale to BPA. MPC also compared the EIRI-2 rates to MPC's marginal and avoidable costs, thereby providing an alternative opportunity cost basis for the EIRI-2 tariff. Aspects of the proposed EIRI-2 rate involving contract length, rates and recovery of the EIRI-2

revenue shortfall follow. 42. First, the EIRI-2 rate terminates on June 30, 1996, after which MPC may continue, without obligation, to serve RPC. MPC chose June 30, 1996, because this reflects the time when MPC must acquire new resources. Second, MPC proposed to increase the energy rates in three steps over the duration of the contract. Table 2 provides these contract rates.

Table 2
Rhone Poulenc Chemical's EIRI-2 Rates

	Present to 6/30/94	6/30/94 to 6/30/95	6/30/95 to 6/30/96
Energy	$.023/kwh	$.0245/kwh	$.026/kwh
Customer	$101,000/mo	$101,000/mo	$101,000/mo

Third, MPC calculated the revenue shortfall as the difference in revenues generated by the II and the EIRI-2 tariffs. (RPC took service from the II tariff up until the EIRI-2 rate was approved on an interim basis in Order No. 5735b). This difference depends on revenue requirement levels from Docket No. 93.6.24 and the Commission's decisions on interim and final EIRI-2 rate levels.

43. Given MPC's testimony, the bearer of the revenue shortfall depends on whether the Commission's initial and final EIRI-2 rate levels are the same. If the final EIRI-2 rates exceed the interim, the final less the interim EIRI-2 price differential is RPC's burden. If the Commission denied the EIRI-2 rate on a final basis, the entire shortfall is RPC's burden. Recovery of the revenue shortfall could be over a year. MPC estimates an annual revenue shortfall to range from $1.67 to $2.47 million (Appendix I, p. 1/1, and MPC DR PSC-1-012). If RPC ceased service, a contractual minimum bill provision would continue to collect costs for the 6 MW of firm load. (Tr. p. 460)

44. In terms of LCP guidelines, MPC finds MCC's proposed sharing of any shortfall between ratepayers (90%) and shareholders (10%) to be a disincentive to making market decisions. (Tr. p. 450)

45. RPC testified on its need for the EIRI-2 rate. RPC

claims the Butte plant is at a competitive disadvantage due to higher electric costs than those faced by its Idaho competitors.

46. MCC did not oppose the EIRI-2 tariff. After performing a cost study, however, MCC found the EIRI-2 tariff not cost based, thus creating a cross subsidy. MCC argued that part of RPC's cross subsidy ought to be a shareholder responsibility. MCC's support of RPC's subsidy assumes shareholders absorb 10 percent. (Tr. p. 517) The following expands on these points.

47. In its cost study for the RPC load, MCC adopted some of MPC's practices and rejected others. MCC used its own generation energy and capacity costs, allocating the former to RPC's entire energy load and the latter to just the firm portion of RPC's load.

48. MCC's transmission cost policies also had some similarities and differences with MPC's. Like MPC, MCC did not allocate transmission costs to the interruptible part of the RPC load. Unlike MPC, MCC allocated transmission energy line losses to the load. MCC concurred with the assertion that because RPC's interruptible load is not allocated transmission costs for 74,000 kw of load, the cross subsidy to RPC from other customers would be exacerbated. (Tr. pp. 334-335) MCC excluded such costs because MPC excludes RPC in its load forecast.

49. MCC testified that the revenue shortfall (cross-subsidy) which results from the EIRI-2 tariff should be recovered from both MPC's ratepayers (90%) and MPC's shareholders (10%). In this regard, and unlike MPC, MCC included the cost to serve RPC in the reconciliation process. Minimally, MCC believes MPC shareholders ought to absorb 10 percent of the shortfall that accrues between the issuance of the October 1993 interim order (Order No. 5735b) and the final order. Ideally, the shareholders would absorb 10 percent of the prospective shortfall. MCC reasons that the Commission is a surrogate for the competitive market, and in a competitive market MPC would have to absorb the revenue loss associated with the EIRI-2 tariff. At hearing, MCC added that if RPC were required to cover its total costs and RPC's demands declined, MPC would have to absorb that revenue until the next rate case. (Tr. p. 333) Having MPC pay part of the cost of attracting load is a way of policing the business of

subsidizing the attraction of loads. (Tr. p. 506)

50. MCC's additional issue testimony distinguished what ought to be the cost basis for RPC in relation to varying lengths of service. If RPC is a short-term load, MCC contends the proper cost basis is the highest-valued alternative use to which the resources could otherwise be used, i.e., an opportunity-cost basis. The value at which MPC can sell power in the off-system opportunity sales market is a relevant cost consideration. In the long run, the only justifiable credit for RPC is for generation capacity.

51. At hearing, Dr. Wilson was given a hypothetical 80 MW high load-factor load and asked whether the costs of serving such a load more closely correlate with the cost of a peakload or a baseload plant. Dr. Wilson was emphatic that such load is less costly served by a baseload plant than a peak load plant. The costs of a baseload plant's energy would be approximately $.03/kwh. (Tr. pp. 142-145)

52. Commission Decision. The Commission's decisions on the EIRI-2 tariff include cost of service, sharing of the revenue shortfall, rate approval and recovery of the shortfall in rates.

53. As a prefatory remark, the Commission finds merit in clarifying the difference between a revenue shortfall and a cross-subsidy. This clarification is needed, in part, because of the freezing of cost decisions in this Docket. Since cost decisions were not made, the Commission does not know what it actually would cost to serve RPC's firm and interruptible loads. Absent such cost information, RPC's cross-subsidy is not known. Yet, a revenue shortfall indeed exists and can be calculated. If cost information existed in this Docket, the EIRI-2 rate could be compared to those costs and the amount of any cross-subsidy determined. In the absence of current cost information, the Commission can only identify a revenue shortfall, which is the difference between II and EIRI-2 revenues. If the cost to serve RPC actually exceeds the EIRI-2 rate level, part of which is otherwise defined as a shortfall is, in fact, a cross-subsidy. In fact, if RPC's current cost of service equaled the past II rate level, the revenue shortfall would equal the cross-subsidy. For the purpose of the following decision, "shortfall" will be

used without any judgement as to whether a cross-subsidy exists.

54. First, MPC's cost basis depends on the type of cost being analyzed. For generation costs, the Commission agrees with MPC's comparison of EIRI-2 energy rate levels to off-system opportunity sales values. At least the energy rates cover the higher of short-run avoided costs or marginal energy costs. In this regard, the Commission notes HRC's testimony that Commissions should not approve discounted prices that do not at least cover short-run incremental costs. (Tr. p. 570)

55. The Commission is concerned over MPC's treatment of capacity costs. Regarding transmission capacity costs the case for not allocating the interruptible portion of the load the same costs allocated the firm portion of the load is highly questionable. The significance of this concern depends on the level of economic transmission costs and the duration of the RPC load. Other costs, such as reactive power, were not estimated.

56. The information on the cost to serve the RPC load is minimally acceptable. Part of the problem is the uncertain level of the underlying costs and another part of the problem relates to the duration of the plant's load, whether owned by RPC or not, and the kind of service MPC will provide the plant over the longer term. The Commission finds MPC has presented a very weak argument for discounting rates to RPC.

57. A second cost issue relates to MCC's proposal to include the RPC load and rates in the reconciliation process, combined with the sharing of the revenue shortfall between ratepayers (90%) and shareholders (10%). The Commission finds merit in MCC's proposal to require MPC's shareholders to absorb 10 percent of the existing past difference between the II and EIRI-2 rate levels. Given the absence of cost decisions, a prospective adjustment can not be made at this time based on costs. However, given the Commission's approval of this tariff an adjustment can be made based on the differential between the prospective II and EIRI-2 rate levels. MPC is directed to make such an adjustment using EIRI-2 rates that will be in place over the next year, not the historical EIRI-2 rates. It is not clear that shareholders should absorb only 10 percent.

58. The third cost area requires some speculation. What

if, for example, after July 1996, MPC continues serving RPC? "No obligation to serve" after July 1, 1996, does not necessarily mean that MPC will not continue serving the plant's load in some fashion. If MPC continues serving the plant's load after 1996, the minimally acceptable cost basis of the EIRI-2 today may be even less defensible.

59. The Commission approves the EIRI-2 tariff. This approval will result in an initial rate increase that declines in subsequent years as the EIRI-2 rates rise and then cease to exist (July 1996). In the last section of this order, the Commission will discuss these and other implementation issues.

III. Stipulations

60. Four stipulations were submitted to the Commission in this Docket.

The Hydro Peak Capability Stipulation

61. The Commission's Additional Issues Notice directed MPC to file testimony on the hydro peak issue, in part to ensure that it would be treated as a formal issue in this Docket (the issue was initially part of Docket No. 93.6.24). The Notice states that a reason to address the issue in this Docket is the impact of hydro peak capability on MPC's marginal and avoided costs.

62. MPC presented a study of its hydro peak capability in its last rate case (Docket No. 90.6.39) which resulted in a new peak capability rating. The Commission did not make a decision on the new rating in that case because the revenue requirement would not have been impacted.

63. MPC testified that there also is not a revenue requirement impact in this case but that the issue should be addressed at this time because the new hydro peak capability is used in the Company's March 1993 Integrated Least Cost Resource Plan, which, in turn, is the basis for the production costs and avoided costs presented by MPC in this Docket.

64. DNRC testified on the importance of MPC's hydro system capability to the resource planning and acquisition process. If the hydro capability value used is too high, MPC is at risk of either being unable to meet peak loads or of having to make very high-priced emergency purchases. If the value used is too low, MPC may acquire more new capacity than is necessary. DNRC stated

that either mistake is likely to be costly for ratepayers and shareholders.

65. DNRC recommended that the Commission order MPC to fund an independent evaluation of its hydro system capability and assure MPC that reasonable expenditures for the study would be recoverable in rates. DNRC also recommended that the Commission request that the Least Cost Planning Advisory Committee be involved in developing the RFP and distribution list, selecting the independent evaluator, and reviewing the evaluator's study.

66. On February 7, 1994 the Commission received a stipulation between MPC, MCC, DNRC and LCG regarding the issue of MPC's hydro peak capability. The parties agreed to accept MPC's proposed hydro peak capability (435 MW) for the purposes of Docket No. 93.7.29 and for any avoided cost filing which the Company may make within one year of the date of the stipulation. In addition, MPC agreed to fund an independent study of its hydro resource capability, including the appropriate length of the sustained peaking period. MPC stipulated to consult with DNRC, the Least Cost Planning Advisory Committee and the other parties to the stipulation regarding the scope of the study, the cost, the list of contractors to be considered and the final choice of contractor. Interested parties would be able to review and comment on the study as it progresses.

67. Commission Decision. The Commission agrees with DNRC that a high quality estimate of MPC's hydro peaking capability is important for sound resource planning and cost of service/rate design decisions. The Commission finds that a thorough, independent evaluation of MPC's hydro system, critically monitored by DNRC, MCC, LCG and members of MPC's advisory committee, will increase the likelihood of obtaining a high quality hydro peak capability estimate. Therefore, the Commission approves the hydro peak stipulation. (MPC Exh. 1)

The Low Income Discount Stipulation

68. The Commission's Additional Issue notice stated that current literature on the subject of low income discounts indicates that a flat rate discount is not the most effective or efficient means of providing assistance to low income customers. The Commission requested that MPC and interested parties justify

their adoption of a flat rate discount and discuss why the following alternatives (discussed in a paper by Roger Colton titled Models of Low-Income Utility Rates) would not be more effective in serving the needs of MPC's low income customers: a marginal cost based rate, percentage of income payment plan, fixed credit approach, percentage of bill approach and available resource approach.

69. A Low Income Collaborative Group (LICG) was formed as a result of a stipulation on the low income discount issue in Docket No. 90.6.39. MPC testified that, pursuant to input from the LICG, it has been working with the Department of Social and Rehabilitation Services (SRS) to find a way to incorporate customer income into the low income discount.

70. In this case MPC proposed to continue the current 10 percent low income discount for qualifying electric customers. Currently, customers who receive LIHEAP (Low Income Home Energy Assistance Program) benefits receive a 10 percent discount applied to their power bills. The amount of the low income discount is recovered from all other customer classes.

71. In its additional issues testimony MPC referred to its efforts to develop a 10 percent discount that incorporates an income factor. According to MPC, the LICG focused on the relationship of income to low income energy assistance. MPC testified that the group briefly discussed some alternatives listed in the Colton paper. According to MPC, these alternatives focused on treating the income factor only on the rate side, while the LICG's preferred approach was to include the income factor in both the distribution of LIHEAP benefits and on the rate side. MPC stated that it has been steadily pursuing an income-based approach with SRS but finished work products were not available at the time of the filing. MPC stated that the goal is to develop a discount approach in which customers with relatively higher incomes would receive a smaller percentage discount and customers with lower incomes would receive larger discounts, but on average the discount would remain 10 percent. MPC stated that the approach is a variation of the Percentage of Income Payment Plan discussed by Mr. Colton.

72. MCC testified that, while it accepts the principle of

low income assistance, it does not believe the proposed low income rate is optimally designed. MCC testified that a low income rate discount applied uniformly to each rate component can distort marginal cost price signals. MCC stated that it would be possible to provide the same level of low income assistance as MPC's proposal, but improve energy efficiency. MCC noted that MPC's 10 percent across the board discount produces a revenue reduction of about $400,000. MCC concluded that the same result could be achieved by eliminating the customer charge and including the first 12 kwh per bill at no charge for qualifying low income customers; or, alternatively, the customer charge could be eliminated and the energy charge for the initial energy block could be reduced by 1.303 mills per kwh. MCC stated that a discount structured in this manner would better address the concerns expressed by the Commission in its Final Order 5484n, Docket No. 90.6.39, FOF 477 and 478.

73. MCC testified that the low income assistance methods discussed in the Colton paper involve detailed assessments of the customer's relative level of poverty, ability to pay or actual income level and would require a more complex and costly administrative process compared to the Company's present method. MCC stated that it would be more advantageous to implement such programs through the existing public welfare system rather than require public utilities to duplicate these administrative procedures.

74. HRC supported the proposed continuation of the 10 percent low income discount. HRC testified that the Commission has explicitly recognized that discounts are a long established practice in Montana and are not contrary to Montana statutes. HRC's testimony indicated that there is no difference between offering an incentive rate to a large industrial customer and offering a discount to low income customers.

75. HRC also testified that there is a cost basis for discounted low income rates. HRC listed several costs associated with low income accounts that can be reduced by discounting service rates for low income customers. These costs include: credit and collection costs, bad debt costs and regulatory expenses related to the regulation of disconnects and consumer

complaints.

76. HRC testified that the LICG reviewed the "more complex proposals" discussed by Roger Colton and decided that a simpler approach would be more appropriate in Montana. HRC testified that neither it nor any other signatories to the stipulation in Docket No. 90.6.39 "dropped the ball on modifying the low income discount." (HRC Exh. 2)

77. According to HRC Mr. Colton emphasizes the cost-based nature of low income assistance in order to make such assistance more palatable to regulators. HRC testified that, while it agrees that there are cost based justifications for low income assistance, it does not agree that net revenue maximization is the sole function of low income assistance.

78. MPC, MCC and HRC reached a stipulation on low income discount issues in this case. According to the stipulation (MPC Exh. 2), the parties agree that the 10 percent low income discount presented in the testimony of MPC witness Pat Corcoran (MPC Exh. 22) is the appropriate low income rate proposal for purposes of this proceeding. The stipulation commits MPC to continue its work with interested parties to consider the incorporation of an income factor into the low income discount. The stipulating parties also agree to further review and consider other low income utility matters such as rate structure and design, alternative approaches to low income discounts, low income outreach and other low income programs.

79. Commission Decision. The Commission adopts and incorporates herein the provisions of the low income stipulation in this case. However, the Commission is not entirely satisfied with the current discount. The issues raised by the Commission in Order No. 5484n concerning appropriate price signals for low income customers in the context of a rate discount were not adequately addressed in this case. The Commission recognizes that there are many complex issues involved in developing an equitable and efficient approach to low income utility bills. MPC should diligently pursue efforts to develop such an approach and should enhance its efforts to address the particular concerns of the Commission regardless of its efforts as part of the LICG.

Production Cost Stipulation

80. This stipulation was described earlier at paragraph 8.

81. Commission Decision. Because production costs will be considered in the cost issues collaborative, a decision on the stipulation is moot. The Commission acknowledges the stipulation for having triggered the broader collaborative effort at resolving cost issues.

Standby Service Stipulation

82. In the course of the hearing, MPC, CELP and LCG submitted a stipulation on Standby Service. MPC offers standby service to QFs served off of MPC's GS-2 tariff. Major revisions to this standby tariff were proposed. CELP and LCG filed substantial testimony criticizing MPC's proposal, after which MPC filed revisions on rebuttal. These parties then worked out the instant stipulation. Paragraph 1. i. of the standby tariff states MPC's Standby tariff, if approved, will be modified by the Commission to establish procedures for determining how to bill Standby customers.

83. Commission Decision. The Commission approves the standby tariff stipulation.

IV. Additional Docket No. 93.7.29 Issues

84. The Commission's November 23, 1993, Notice contained seven additional issues on which parties later provided direct and rebuttal testimony. Two of these issues, hydro peaking and low income discounts, were addressed above in the section on stipulations. Another, the RPC/EIRI-2 issue, was addressed under rate design. Because the Commission expects the cost collaborative will address two other additional issues, the "Off-system Opportunity Sales Values" and "Cost Basis For Off-peak Winter and Summer Capacity", they will not be discussed here. There are two additional issues remaining: "Rate Design Experiments" and "Externalities and Pricing."

Rate Design Experiments

85. In its additional issues Notice the Commission asked for testimony on the use of rate experiments to identify rate designs consistent with least cost planning guidelines. Other rate design issues, involving interruptible time-of-day, weekend usage and inverted irrigation demand charges were also raised.

86. MPC responded to these additional issues by stating

that it is just beginning to investigate how to reflect rate design in least cost planning. Pending additional studies, and answers to other questions, MPC believes it is premature to recommend any such rates or structures in this Docket.

87. Regarding an interruptible-peak and firm off-peak tariff with customer supplied storage, MPC stated a "generic" interruptible rate already exists, off of which no customer has chosen to take service; MPC added that the cost of providing interruptible service to secondary voltage customers makes such service impractical. MPC stated the value of interruptible loads must reflect the customer's load at interruption and whether the customer remains interrupted for the duration of the request to interrupt. MPC added that the Company's conservative approach to interruptible rates stems from a continuing controversy over the value of such loads.

88. With regard to weekend rates (e.g., churches), MPC concluded further study is needed before any rate is offered. While noting the equity implications, MPC added that a time-of-use rate may be more appropriate. MPC conceded that if a customer group has a different load shape, different rates may have merit, but costs must be considered. In lieu of interruptible or weekend rate options, MPC suggested time of use rates may be better.

89. Commission Decision. Generally, the Commission is pleased with MPC's recognition that rate design impacts cost of service. Cost of service, rate design and integrated least cost planning are connected. The sensitivity of RPC's load to the EIRI-2 rate level and the MPC employees' response to a 40 percent discount should convince anyone who doubts the impact of pricing. An interesting question, however, is what costs could be saved if prices and rate structures were changed. The Commission encourages MPC to continue exploring how rate design can impact cost of service. As evidenced by the state of costing in this Docket, any experimental rate design effort would be premature at this time. The Commission intends to raise the issue of experimental rate design in MPC's next docket involving rate design, thus continuing an inquiry that began in 1989 (Docket No. 88.6.15, Order No. 5360d, FOF No. 589).

Incorporating Externalities In Prices

90. The Commission's Notice on additional issues indicated that Docket No. 93.7.29 is MPC's first cost of service and rate design filing based on the Commission's December 1992 least cost planning rules. The LCP Rate Design guideline states that the influence of external costs should be incorporated into prices proposed in rate cases. ARM 38.5.2008 (1) (b). The Commission sought additional testimony in order to consider the issue of incorporating external environmental costs in prices.

91. MPC first commented on what is meant by external costs. MPC stated that external costs from an action exist when the parties causing the action do not fully consider the detrimental side effects that accompany that action. MPC testified that one major problem involved in including external costs in pricing is measurement. According to MPC this problem results because externalities are, by definition, outside the market, which greatly complicates their valuation. MPC stated that agreement about the value of specific externalities is very difficult to obtain.

92. MPC asserted that a second problem with attempting to reflect external costs in prices is that revenues are not allowed to exceed embedded costs. MPC noted that this problem is no different than the current problem of trying to reconcile marginal costs with the embedded revenue requirement. And, without explanation as to who comprises "few," MPC claimed few are satisfied with how this process works.

93. As a third problem, MPC pointed to the theory of the "second best." MPC stated that including external costs in prices for electricity may not always make society better off if external costs are not internalized across the whole spectrum of economic activity. For example, MPC stated that raising the price of electricity to include external costs might shift consumers' choices to other goods and services, the production of which causes even more external costs.

94. MPC stated that if external costs are to be reflected in rates, they should be reflected just like any other marginal cost; for example, external costs associated with transmission activity should be reflected in marginal transmission costs and

be allocated to the users of transmission services in prices.

95. MPC stated that a search of data sources would be an early step in a serious scoping study of this issue. MPC also stated that damage costs should be estimated, rather than control costs.

96. MPC stated that external costs should be included in the dispatch decision process. However, MPC qualified this statement with two cautionary statements. First, MPC again noted the problem of measurability. Second, MPC stated that there are potentially drastic impacts on a utility's competitive position vis a vis other utilities if all utilities in the region are not also required to include external costs in their dispatch choices. MPC concluded that implementing actions to include external costs in electric rates is premature at this time.

97. MCC testified that external environmental costs can be internalized by requiring utilities to invest in pollution abatement facilities and use clean fuels. MCC stated internalization can also be accomplished by taxing utilities for environmental degradation costs.

98. According to MCC the "second best" problem "has some theoretical validity but is not generally accepted as a sufficient basis for excluding external costs from ratemaking consideration when reasonably accurate quantification is possible." (MCC Exh. 2)

99. MCC testified that, in the case of electricity generation, the major undisputed external costs relate to the pollution which results from power generation. MCC stated that special care should be taken not to understate the rate components that are most directly related to environmental externalities. According to MCC, where a range of reasonableness is determined for marginal energy costs, a decision at the upper end would be appropriate given that there are known, but difficult to quantify, externalities associated with kwh consumption.

100. MCC stated that in analyzing the externality issue it should be remembered that environmental externalities are not the only externalities that may be relevant. MCC noted that there may be some external benefits associated with some aspects of

electric power consumption.

101. DNRC testified that including externalities in rates would promote electricity consumption decisions that are better aligned with the interests of society. However, DNRC stated that the revenue requirement constraint presents a problem. DNRC also stated that the uncertainty surrounding the value of external costs is another problem. DNRC recommended that the Commission not attempt to settle the issue in this Docket but should open a separate docket to address the issue.

102. DNRC testified that the Commission should distinguish between real and financial externalities. According to DNRC real externalities are associated with the actions of the utility, i.e., the air and water impacts associated with the operation of a thermal plant which are not reflected in the internal costs of the utility. Financial externalities exist when prices do not recover the full marginal internal costs of service. DNRC used the example of a line extension policy where the hookup charge does not cover the marginal cost of extending lines, thus, causing customers to locate farther from existing lines than they otherwise would and farther than is socially optimal.

103. DNRC stated that the appropriate methodology to use for quantifying external environmental costs is the marginal damage cost. DNRC stated that since the information on damage costs is sparse, control costs have been used as a proxy, but they are a very imperfect proxy.

104. With respect to environmental dispatch, DNRC testified that it has been shown to provide a cheaper way of obtaining environmental cleanup than the use of either adders or mandatory scrubbers on new generating facilities. The difficulty, DNRC stated, is trying to do environmental dispatch at one utility when short-term transactions between utilities occur on the basis of marginal internal operating cost only. DNRC recommended that the Commission revisit this issue in MPC's 1995 IRP.

105. LCG testified that, if externalities are to be handled correctly, all of MPC's functional costs must necessarily include them. Thus, if negative externalities associated with generation are added to energy costs, then externalities associated with distribution should be added to the marginal distribution costs.

In addition, LCG noted that fluorescent lamps contain PCBs and old refrigerators contain CFCs so that externalities would also have to be added to DSM costs. LCG concluded that the task would be a "pragmatic nightmare." (LCG Exh. 3)

106. LCG asserted that there is virtually no agreement on the value of external costs nor is there any agreement on how to calculate these values. LCG also stated that including externalities will not guarantee that consumers will receive more correct price signals because the revenue requirement would not change. LCG stated that including externalities in prices may have the opposite effect from that intended by driving consumers to another source which may be more polluting.

107. Commission Decision. The relevance of including externalities in prices really begs the question of whether prices serve any useful efficiency purpose. If one believes pricing is of secondary importance, it probably serves no useful purpose to bother with the issue. If on the other hand one believes prices do serve a unique role in allocating society's scarce resources, then the inclusion of externalities in prices is essential. The Commission concludes that pricing does serve a uniquely important role in allocating society's scarce resources.

108. The Commission believes that ratemaking goals and integrated resource planning and acquisition goals must be consistent and complementary. ARM 38.5.2008 states that rate design is a key element in the integrated least cost planning process and that the goals and objectives of all rate design efforts should be consistent with the goals of least cost planning. ARM 38.5.2001 states that the Commission's regulatory goal is to efficiently allocate society's resources to the provision of electricity services and ensure just and reasonable rates. The Commission's decisions on externalities are based, in part, on these two rules.

109. The Commission believes that part of what makes a rate just and reasonable is its ability to allow a customer to make consumption decisions which cause society's resources to be allocated most efficiently between electricity production and other possible uses. In order for this to happen the rate must include as much information as possible about the cost society

incurs when additional resources are committed to electricity production instead of some other use. Thus, ideally, a just and reasonable rate would be as close as possible to the marginal social cost, i.e., the sum of the utility's marginal internal costs and any externalities. The Commission's interest in incorporating externalities into prices is simply part of its desire and obligation to ensure that rates are just and reasonable.

110. However, as testified to by MPC and the intervenors, many factors currently prohibit the Commission from setting ideal rates. Nevertheless, the Commission believes it is obligated to pursue better rates while recognizing the need to be aware of the environment in which the rates must operate. The Commission believes the electric industry and the economy in general are subject to many inefficiencies. However, the Commission believes there are opportunities to increase efficiency (i.e., social welfare) through the application of sound economic principles and public policy. Such opportunities should be pursued.

111. One reason for raising externalities as an additional issue was to determine what additional information would assist the Commission in moving rates in the right direction. Although the response was less than overwhelming, the Commission makes the following decisions.

112. MPC testified that an early step in a serious scoping study would be a search of data sources. (MPC Exh. 7) The parties, including MPC, also testified that marginal damage costs are the appropriate costs to estimate when valuing externalities. The Commission agrees with this testimony. The Commission directs MPC to conduct a thorough search of data sources and develop a range of marginal damage cost estimates applicable to its generation, transmission and distribution of electricity. MPC is also directed to estimate a range of marginal damage costs applicable to its off-system power purchases. These damage costs should be expressed in dollar terms per unit of consumption (access, KW, Kwh). The Commission recognizes that such estimates will necessarily involve uncertainty, but the Commission believes it is inappropriate to continue designing rates under the assumption that the value for externalities is zero.

113. The Commission will not limit the externalities for which MPC may estimate damage costs. However, the Commission believes that at a minimum MPC should estimate damage costs associated with Carbon Dioxide (CO_2), Sulfur Oxides (SOX), Nitrogen Oxides (NOX), Volatile Organic Compounds (VOC) and Particulates. The damage cost estimates should reflect, at a minimum, the impacts on human health, agricultural crops, timber, livestock, ecosystems and biodiversity, global climate, recreation, visual and audio aesthetics and land use (including property values).

114. The Commission directs MPC to provide cost estimates for the above externalities in its next rate filing, the ultimate purpose of which will be efficient pricing. MPC is encouraged to involve its Least Cost Planning Advisory Committee in developing the damage cost estimates and investigating whether such estimates may be used in the integrated resource planning process perhaps as a substitute for, or a complement to, the environmental externality adjustment factors (EEAFs).

V. Issues Reserved to MPC's Next Cost of Service Docket

115. The Commission continues its past practice of alerting MPC, and others, to policy and technical issues that are premature to address in this Docket, but on which testimony is expected in the next cost of service filing. These reserved issues follow.

Avoidable, Opportunity and Marginal Costs

116. Although this issue will focus on a distribution and transmission question, the general issue would apply to any cost function. The general issue is how to account for different avoidable, marginal and opportunity costs for the same cost function, in an economic cost study. The Commission intends a more robust integration of avoidable, opportunity and marginal costs in the next docket and requests prefiled direct testimony on the topic.

117. In this Docket, the only marginal energy costs for transmission and distribution (T & D) are line-loss-related. Yet, based on information derived from Docket No. 93.6.24, it

appears avoidable energy costs exist in addition to those that are just line-loss-related (see Dick Snell's June 16, 1993, Memo titled "T & D Efficiencies Resource Summary", MPC's response to PSC DR No. 45, Docket No. 93.6.24). One question then is, if non-line loss avoidable T & D energy costs exist, why are they not in MPC's cost study? The Commission directs MPC to address this issue and the general issue in its next cost of service filing.

Transmission Cost Causation

118. Another issue involves the type of load (firm, interruptible, standby) that should be allocated transmission costs. All parties allocate transmission costs to firm loads. MPC allocates transmission costs to interruptible loads, except for RPC's interruptible load. The stipulation on standby service, signed by MPC, CELP and LCG, charges standby customers for transmission service and thus implicitly allocates transmission cost to such customers. MCC did not allocate RPC's interruptible load any transmission costs. The Commission requests MPC to also address this issue in its next cost of service filing.

Off-System Opportunity Sales Values

119. Notwithstanding an expectation that the collaborative will consider such costs, the Commission intends an analysis of such markets for purposes of directly estimating energy and capacity costs. In this regard, both non-firm and firm and short-term and long-term cost issues will be raised. Thus, MPC is requested to testify on such matters in its next filing

Improving The Quality of Price Information

120. The Commission wants to improve the quality of price information conveyed to customers via MPC's tariffs and customer bills. MPC's tariffs often feature energy and capacity rates that have up to seven significant digits (e.g., $.064495/kwh and $7.630867/kw). Energy and capacity prices should only contain three significant digits (e.g., $.0645/kwh and $7.63/kw). Since these simplifications may hamper MPC's ability to accurately collect its allowed revenue requirement, the Commission requests MPC to propose mechanisms that would account for the difference between allowed and actual revenue collections. Other changes

that may improve the quality of service may be debated once MPC's next cost of service and rate design case is filed. Such changes may include graphical price, cost and consumption information.

VI. Implementation of Revenue Impacts

121. There are complications involved in implementing rates out of this Docket because of the status of Docket No. 93.6.24, the freezing of cost decisions, and the approval of the EIRI-2 tariff. The freezing of cost decisions leaves the Commission one option for rate changes: uniform percentage rate changes. The EIRI-2 rate approval gives rise to a one-time rate increase to capture the historical revenue shortfall and the need for a permanent rate increase for the prospective shortfall. Timing and coordination are central to the objective of minimizing rate changes.

122. The Commission finds the following decisions will minimize the number of rate changes that occur out of this Docket and Docket No. 93.6.24. MPC must implement the recovery of the net (90 percent) EIRI-2 historical shortfall on July 1, 1994. MPC must provide workpapers that document its estimate of RPC's usage through June 30, 1994. MPC must attempt to recover the historical EIRI-2 shortfall over a one-year forecast market. The recovery of the net prospective shortfall must use the 1992 sales markets, as MPC initially proposed. On July 1, 1995 and again on July 1, 1996, MPC is to lower rates to reflect the increase in EIRI-2 rates, relative to those in place beginning July 1, 1994. Finally, MPC's Customer Charges that combine the recovery of the EIRI-2 net shortfall and any changes out of Docket No. 93.6.24, must be rounded to the nearest nickel.

CONCLUSIONS OF LAW

1. All Findings of Fact are hereby incorporated as Conclusions of Law.

2. The Applicant, Montana Power Company, furnishes electric service for consumers in the State of Montana and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. Section 69-3-101, MCA.

3. The Montana Public Service Commission properly exercises jurisdiction over Montana Power Company's rates and operations. Section 69-3-102, MCA, and Title 69, Chapter 3, Part

3, MCA.

4. The Montana Public Service Commission has provided adequate public notice of all proceedings and an opportunity to be heard to all interested parties in this Docket. Section 69-3-303, 69-3-104, MCA, and Title 2, Chapter 4, MCA.

5. The cost of service and rate design approved herein are just, reasonable, and not unjustly discriminatory. Section 69-3-330 and 69-3-201, MCA.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION HEREBY ORDERS:

1. Montana Power Company's electric cost of service shall continue to reflect Commission decisions in Docket No. 90.6.39, Order Nos. 5484n and 5484r.

2. The Montana Power Company shall comply with each requirement and direction of this Order as described above.

3. The Montana Power Company's requests for tariff changes are granted and denied as described above.

4. The Montana Power Company shall flow through historical and prospective RPC shortfalls and provide supporting workpapers as described above in paragraphs 120 and 121.

5. With the exception of the production cost stipulation, the stipulations entered into by the parties to this Docket are accepted and approved as discussed above.

6. All other motions or objections made in the course of these proceedings, which are consistent with the findings, conclusions and decisions made herein are Granted, those inconsistent are Denied.

DONE AND DATED this 13th day of June, 1994 by a 5 to 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ANDERSON, Chairman

BOB ROWE, Vice Chairman

DAVE FISHER, Commissioner

NANCY McCAFFREE, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.

OPINION OF COMMISSIONER ROWE

Cost of service issues are contentious, with enormous ranges between the positions taken by various parties. Cost of service studies predictably employ methodologies and produce results consistent with the proponents' interests. The Commission's responsibility is to sort through this mass of conflicting evidence to discern a defensible approach which serves those legitimate public goals the Commission is charged to advance.

I. COST OF SERVICE COLLABORATIVE.

The relatively small revenue requirements change resulting from Docket 94.6.24 provides the Commission and stakeholders an opportunity to carefully review a series of recurring issues in a less adversarial setting. I was initially skeptical about the prospects for a collaborative's success, and was prepared to make cost of service and rate design decisions based upon the record before us. However, I am impressed by the parties' willingness to undertake the effort, and by the reasonableness of the stated goals. The weight I will afford any final product should depend in part on the ability of some of the smaller stakeholders to participate effectively.

II. IRRIGATION RATE DESIGN.

Irrigation rate design is a continually frustrating topic. Despite a number of attempts in this docket, we have not successfully addressed some legitimate concerns (setting aside general complaints about rates being "too high"). Aggressive demand-side management may offer a partial solution. As MPC expands its work in this area, I encourage it to study the experience of other successful programs, such as the Idaho Power Company/Bell Rapids Mutual Irrigation Society project recently recognized by the Northwest Power Planning Council.

III. DISCOUNTED RATES.

Three electric rate discounts were discussed: RP Chem's proposed incentive rate, causing a revenue shortfall of over $1.5 million annually; the existing forty percent MPC employee discount with an electric revenue requirement effect of around

$743,000 annually; and the existing moderate and low income discount with an electric revenue requirement effect of around $360,000 annually. I am displeased by the tendency of several parties to justify their preferred discount by reference to other discounted rates, rather than on the merits of their own proposal. I am also dissatisfied with the answers witnesses provided to my questions concerning appropriate bases for distinguishing among discounted rate proposals.

Determining that the rate covers short-run incremental costs is only the first issue to be addressed. After that, the Commission, the utility and other parties need to take a disciplined look at each specific proposal. The following list of questions represents my initial thinking, and is fair game for debate:

1. Does the discount further legitimate economic and non-economic goals of utility policy?

2. Do the direct costs trigger potential benefits to the system?

3. Are the customer benefits widely distributed, or do they fall to a narrow class?

4. Are the non-customer benefits properly defined?

5. Are the non-customer benefits widely distributed, or do they fall to a narrow class?

6. Is the discount part of a larger utility program, with appropriate goals?

7. Is the discount part of a least cost approach to achieving those goals?

8. What is the cumulative direct cost of the discount?

9. Does the discount significantly distort the price signal, and if so are other countervailing measures

available or is the distortion outweighed by other factors?

10. Is the discount consistent with rate design principles including public acceptability and understandability?

Assuming these are among the right questions, one or more of the three programs would have some difficulty passing muster. The Commission must think through these issues more directly in the future.

A. Forty Percent Employee Discount.

The employee discount is both a rate design and a revenue requirements issue. No one argued that MPC employees are not entitled to the amount of compensation reflected in the discount. It is also true that employee discounts are a common form of compensation in many industries. The best argument for continuing the discount is that it may avoid income taxation, which would either diminish the net value of direct compensation or raise costs to ratepayers.

At the same time, the discount raises questions of public acceptability and fairness and is by definition available only to a narrow class and without regard to need. The discount clearly induces significant inefficient consumption.

Witnesses agreed it would be reasonable to address the issue in the next revenue requirements docket, in order to minimize any disruption to affected employees. It may be reasonable to move the discount toward the twenty percent allowed by IRS rules, thereby avoiding any adverse revenue requirements effect. MPC should work to ameliorate the effects of substantial price signal distortion.

B. Rhone Poulenc Chemical.

Rhone Poulenc Chemical already receives a lower "interruptible" rate. It is MPC's only interruptible customer. While interruptibility does have value to the system, there remain serious questions about the way MPC's current interruptible rate is structured, and about whether the value of interruptibility is equal to the cost of the lowered rate.

In October, the Commission fell over itself to approve the even lower "retention" rate on an interim basis. I was the only dissenter. The shortfall due to the interim discount, from October 15, 1993 until July 1, 1994 (when the permanent discount takes effect) is about $1.65 million.

The primary justification for a retention rate in this case - and the one which appears to have motivated Commissioners - is to preserve RP Chem as a customer, thereby preserving a number of very good jobs in the local economy. (RP Chem competes with plants in Idaho and Utah which somehow obtained low electricity prices.) It strains credulity to suggest that if the interim retention discount had not been approved, RP Chem would have closed its doors even while the permanent retention discount was pending. Because RP Chem almost assuredly would not have shut down while its proposal awaited final action, the interim will cause an unjustified about $1.485 million transfer of wealth from all MPC customers to one MPC customer (after the ten percent shareholder contribution we are now ordering).

Approval of the final retention rate is primarily cost-justified only if RP Chem is in fact a short-term load, making the opportunity-cost of an off-system sale a relevant consideration in pricing. If in fact RP Chem remains an MPC customer past two years, the cost of generation capacity becomes the most relevant factor in determining the cost of service to RP Chem. In that event, the Commission will have allowed RP Chem to be significantly undercharged. Questioning during the hearing provided almost no insight into possible future arrangements.

Ironically, uncertainty about the load's future was offered as a reason for not pursuing aggressive demand-side management. DSM ought to be part of a real solution to RP Chem's competitiveness problem.

The total cost of various discounts received by RP Chem and its predecessor, dating back to 1982 when the plant first became an MPC customer may be somewhere between $50 and $100 million. The Commission should instruct staff to determine the amount with more precision. Whatever the exact amount, it is a staggering transfer of wealth from every MPC electric customer in the state. I do not slight the significance of good jobs retained at the

Silver Bow facility or of local and regional economic activity spurred by RP Chem and its predecessor. Nonetheless, a significant amount of value has flowed out of state.

Assume the premise of economic development as a ratemaking criterion. Also assume the Silver Bow phosphate plant would actually have shut down without the discount. The question remains whether more economic activity might have been generated had that wealth remained distributed throughout the Montana economy?

The RP Chem retention rate fails many of the standards I proposed. For reasons unclear, the Montana Consumer Counsel did not oppose the discount, but did support a ten percent shareholder contribution. No other party addressed the issue. I vote for the final order because I was able to help construct a concrete mechanism for recovering a ten percent shareholder contribution for the final as well as interim amounts of the discount.

C. Moderate and Low Income Discount.

My very strong support for this program is well-known. MPC's ten percent discount meets most of the standards I have suggested. It is consistent with legitimate policy goals, potentially benefits the system, distributes benefits widely among eligible customers, and distributes non-customer benefits system-wide. The discount is integrated into a larger MPC effort to address significant utility and customer issues. Of the three discounts, this program has by far the lowest direct cost. Evidence in the MPC revenue requirements case, Docket 93.6.24, indicates the program is beginning to produce savings in reduced uncollectibles. The program is easy to understand. It enjoys broad support. Indeed, my sense is that it helps improve MPC's standing among many customers, including non-participants.

Particularly at ten percent, distortion to the price signal is minimal. Concern about price distortion is offset by the severe income constraint faced by participants, by the fact most participants are near the minimal level of necessary consumption, and by coordination with various weatherization programs. At this time, my preference is for rate-related approaches as opposed to eliminating the customer service charge, as there is a greater correlation between the need for and the amount of the benefit.

I have several additional comments.

1. The program is mislabelled as a low income program. Eligibility is set at 125 percent of poverty, currently $17,983 for a family of four. In Montana, 170,237 people, twenty-two percent of the population, fall below this line. The program potentially benefits a reasonable portion of Montanans with legitimate payment constraints, including many seniors, disabled persons, and working families. Change the name!

2. MPC deserves credit for its efforts. This is one of several areas where MPC is doing a very good job, and deserves recognition and credit. In California, there are concerns that "social programs" and demand-side efforts must be jettisoned in newly competitive retail markets. However, if done well efforts such as MPC's may help position it as a respected first-choice provider of energy services.

3. More can be done. I partially accept the parties' defenses of existing efforts: Stability, gradualism, and significant improvements in the LIHEAP matrix resulting from their efforts. I am not satisfied that a ten percent discount is the correct amount or that flat discounts best meet both the economic and non-economic purposes of residential assistance programs. I was disappointed that proponent's witnesses were unable to respond to my questions about what we should do differently or better.

4. The Commission had it coming. I strongly agree with the biting criticisms of the Commission's confused direction in this area. I reject arguments in favor of residential rate programs based upon the existence of other reduced rates. However, I completely agree that the Commission's willingness to approve other non-residential discounts while rejecting residential discounts in some cases and subjecting them to a much higher level of scrutiny in others does indicate (probably unintended) bias. The Commission's haste to approve an interim RP Chem retention rate in this case is only the most recent example of disparate approaches. I am unaware of any comparable interim rate design order ever issuing on the residential side. This

looks like a double standard.

In part, the intervenors' defensive position in this case may have been a reaction to the Commission's confused approach. My sense was that there existed little danger the Commission would reject continuation of the program. However, a fair reading of other recent Commission actions was that the program was very much in danger.

RESPECTFULLY SUBMITTED this 13th day of June, 1994.

BOB ROWE
Vice Chair

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